SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

No.....

SOUTHEASTERN BUILDING CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion of the Tax Court (Disney, J.) was promulgated February 29, 1944, and appears on record pages 32-47 (the opinion proper beginning on record page 38) and is reported in 3 T. C. 381. The opinion of the Circuit Court of Appeals for the Fifth Circuit (McCord, J.) was filed Aprii 19, 1945, and appears on record pages 72-76. It is reported in 148 F. (2d) 879.

II.

JURISDICTION.

The essential facts relative to the jurisdiction of this Court are fully stated in the accompanying petition for certiorari (supra, page 5) and in the interest of brevity are not repeated here.

III.

STATEMENT OF CASE.

Petitioner acquired the building in question, located in Atlanta, Georgia, on January 2, 1933 (R. 33), subject to a first mortgage then outstanding in the principal sum of $171,500.00 (R. 34) and subject also to a lease to Western Union Telegraph Company, a New York corporation, expiring December 31, 1943, and calling for a rental of $17,000.00 per year (R. 35). At the date of acquisition by Petitioner, Western Union was using the building as one of four similar warehouses in the United States (R. 36), and paid all rentals called for by the lease to Petitioner after January 2, 1933 (R. 35).

The building was erected upon a site especially chosen by Western Union (R. 56) and built according to plans and specifications required and approved by Western Union (R. 56). It was specially built to be occupied by Western Union as a storage warehouse and supply depot (R. 56), the first floor being built to carry almost unlimited loads and the second floor to carry from 200 to 250 pounds per square foot (R. 36), whereas the floors of a typical warehouse in Atlanta, Georgia, are built to carry only 125 pounds per square foot (R. 61). Consequently, the Tax Court found Petitioner's building "is built very substantially beyond the requirements of an ordinary storage warehouse" (R. 36).

Western Union vacated the building in July, 1934 (R. 36), but continued to pay the rent called for by the lease.

They sublet the building from February 1, 1935, to December 31, 1938, at an annual rent of $5,685.11, petitioner corporation assenting to the sublease on February 27, 1935 (R. 36). On December 14, 1938, Petitioner assented to a sublease for the year 1939 at $4,800.00 per annum (R. 36). On August 23, 1939, Petitioner assented to a sublease for a term beginning January 1, 1940, and ending concurrently with the original lease on December 31, 1943, at $6,000.00 per annum (R. 36). During all of these subleases Western Union continued to pay the $17,000.00 per year rental called for by its lease (R. 66), and there is no evidence it made any effort to avoid that lease.

Although 1939 taxes are at issue in this case, it was not tried before the Tax Court until May 14, 1943, and up to the time of trial the Petitioner had been unable to find a tenant who would use the building as a "special purpose" building and who would be willing to pay the higher rent which the building commanded as a "special purpose" building as distinguished from an ordinary warehouse (R. 37).

Under the foregoing facts the Tax Court held and the Circuit Court of Appeals affirmed that extraordinary obsolescence would not be allowed, as Petitioner had failed to prove that the physical life of the building had been shortened by the abandonment of its special use. The taxpayer, Petitioner herein, never contended and does not now contend that the physical life of the building or its useful life as a mere building was in any sense shortened by the event (abandonment of the lease by Western Union), but has maintained and here contends that such event definitely established that the building's "special purpose" life was shortened and terminated and gave rise to an allowable deduction for obsolescence.

IV.

SPECIFICATION OF ERRORS.

(1) The Circuit Court of Appeals erred in failing to allow as a deduction from Petitioner's gross income for the year 1939 the extraordinary obsolescence resulting from the abandonment by the tenant of the special use for which Petitioner's "special purpose" building had been built.

(2) The Circuit Court of Appeals erred in holding that extraordinary obsolescence will not be allowed unless taxpayer proves that the estimated physical life of the property has been cut short by the abandonment of its use for the "special purpose" for which it was built.

(3) The Circuit Court of Appeals erred in failing to hold that the abandonment of the use of Petitioner's building for the "special purpose" for which it was built resulted in a loss which was deductible as extraordinary obsolescence.

V.

ARGUMENT.

The decision of the Court of Appeals (as well as that of the Tax Court) is bottomed solely upon the proposition that the Petitioner failed to sustain the burden of proof required to entitle it to an allowance for extraordinary obsolescence solely because it had failed to "show the useful life of the property has been shortened" (R. 75).[1] Petitioner insists that under the prior decisions of this Court it is not required to carry any such burden of proof. This Court's decisions require only a showing of an unanticipated external event over which taxpayer has no control and which has caused the building as a whole to suffer diminution in value. Such showing is sufficient in itself, entirely apart from a showing of any shortened physical life, to entitle a taxpayer to a deduction for extraordinary obsolescence in computing Federal Income Tax.

The Petitioner herein respectfully insists that its position just above stated is expressly supported by two important decisions of this Court, **U. S. Cartridge Co. v. U. S., 284 U. S. 551, 76 Law. Ed. 431,** and **Burnet v. Niagara Falls Brewing Company, 282 U. S. 548, 75 Law. Ed. 594.** The decision of the Circuit Court of Appeals ignores and conflicts with the decisions just cited.

In **U. S. Cartridge Co. v. U. S.,** supra, the facts show that the Cartridge Company in 1914 built certain buildings for the "special purpose" of manufacturing ammunition for World War I. They were built on leased ground with the understanding that in 1924 (ten years later) they

[1] It may be noted that the Tax Court's holding on this point is inconsistent with its own prior decisions. Cf. **First National Bank of Mobile, 30 B. T. A. 632,** where it is stated "it is now generally known that the economic usefulness of office buildings is shorter than their physical life." **International Shoe Co., 38 B. T. A. 381,** where the Tax Court allowed an increased depreciation rate to cover obsolescence where the advent of high speed machinery made a multiple story factory less desirable despite the fact that the physical life of the building would remain unchanged, only its life for its "special purpose" as a shoe factory being affected.

would be turned over without cost to the owner of the land on which they were built. Thus, the buildings for taxpayer had a useful economic life of ten years, during which period the Cartridge Company could recapture their cost by depreciation deductions. The buildings were fully used for their "special purpose" until the Armistice in 1918. After the Armistice the company continued to use the property, though at no profit, until the lease ended on December 31, 1924. In other words, neither the physical nor the useful life of the buildings was cut short by the Armistice and the consequent abandonment of the "special purpose" for which they were leased; instead, as the Court said, the only result of such abandonment of special use was "a great diminution in value of the building in 1918." On such basis, this Court held the extraordinary obsolescence all occurred in 1918, when the Armistice and the reduced income from the property occurred, and announced the following rule for computing the resulting obsolescence **(76 L. Ed., l. c. 435)**:

> "The depreciated cost less the value of petitioner's right to use the buildings after 1918 must be taken into account for the proper determination of petitioner's 1918 income and profits tax."

This is precisely the point for which Petitioner in the case at bar is contending, for in this case the future loss of value resulting from abandonment in 1943 became definitely predictable at either one of three earlier dates.[2] The

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2 To-wit, July 1934, when Western Union closed the supply depot and moved out of the building; or in 1935, when the petitioner assented to the first sub-lease; or in August 1939, when petitioner first learned that Western Union had sub-let the building for the entire unexpired term of the lease.

The Court of Appeals found (R. 74) "the taxpayer was informed in July, 1934, that at the expiration of its lease agreement Western Union would not renew such lease." The petitioner does not agree with such finding, but a consideration of this point is not essential to a discussion of the issue presented by this petition for certiorari as the erroneous finding goes only to the question of the amount of the claimed deduction (which the Court of Appeals denied), whereas the petition herein asserts the right to a deduction for extraordinary obsolescence under the prior decisions of this Court.

deduction for extraordinary obsolescence can be taken whenever it is definitely predictable that the "special purpose" use will be abandoned, whether it be immediately upon the happening of an event or in the future.

The **Treasury Department Bulletin F (1942 Edition)** so concedes. At page 3 it is said:

> "Extraordinary or special obsolescence rarely can be predicted prior to its occurrence. However, this does not necessarily imply that the asset already must have been completely discarded or become useless, but merely that a point has been reached where it can be **definitely** predicted that its use for its present purpose will be discontinued at a certain future date. Deductions for obsolescence **of this type** may be taken over the period beginning with the time such obsolescence is apparent and ending with the time the property will become obsolete." [3]

The principle for which Petitioner contends was reaffirmed by this Court in **Burnet v. Niagara Falls Brewing Co., 282 U. S. 548, 75 L. Ed. 594.** The facts in that case are substantially identical with those in the case at bar. A brewery's property at the end of 1917 had a depreciated cost of $477,054.60, which, after deducting allowances in 1918 and 1919 for exhaustion, etc., was reduced to $279,-117.08. This Court said, **75 L. Ed., l. c. 596:**

> "But due to prohibition laws its actual value at the end of 1919 was only $90,475. That is $188,642.08 less than book value after such deductions."

After 1919 the company used only part of the building until 1921, when it ceased brewing. In 1922 the property was leased to others and in 1928 was still under lease at $5,000.00 per year. There was no proof in the case that the

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[3] Citation is substantially identical with Bulletin F (1931) applicable to the year here in issue. For further quotation from the same source, see: Appendix, infra.

physical or useful life of the building was shortened by the adoption of the Prohibition Amendment (which was the cause of the abandonment of the special use for which the building had been constructed). On the contrary, its economic and useful life continued (it was leased for other purposes) even though its "special purpose" life was terminated by the unpredictable event of prohibition. This Court allowed the taxpayer to deduct the extraordinary obsolescence resulting therefrom, to be apportioned between the two years 1918-1919, the period during which the brewery knew for certain that prohibition would become effective, and the time it actually occurred and the special use of the property was abandoned. There, as here, the property continued to be useful after such abandonment of its "special purpose" use, though for a different and less productive purpose.[4] This Court further held that there was no requirement on the taxpayer to show that the original estimated useful life of the property was cut short by the abandonment, **75 L. Ed., l. c. 598:**

> "In determining the proper deduction for obsolescence there is to be taken into consideration the amount probably recoverable, at the end of its service, **by putting the property to another use** or by selling it as scrap or otherwise. There is no hard and fast rule, as suggested by the Government, that a taxpayer must show that his property will be scrapped or cease to be used or useful for any purpose, before any allowance may be made for obsolescence."

There was no finding that the residual value of $90,475 should be depreciated over any shorter term than originally estimated, or that either the physical or useful life

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4 "A building used for manufacturing may become useful only as a warehouse. If this can be definitely shown to the satisfaction of the Commissioner, an allowance for obsolescence would be permissible, in addition to an allowance for depreciation. The useful life of the building may not be diminished, but the character of its use may be changed and thereby a substantial part of its value may be lost." G. E. Holmes, in **The Federal Income Tax, Columbia University Lectures** (1921), p. 152.

of the property had been shortened. Similarly, in the **Cartridge Company case**, supra, the taxpayer used the building for the entire period of its life, for its physical and economic life was not impaired by the ending of the war; only its "special purpose" life was terminated by the external event over which taxpayer had no control. The allowance of the extraordinary obsolescence in that case and in the **Brewery case**, supra, was in no way made dependent upon a showing of diminution of physical life.[5]

The decisions in the two cases above discussed directly refute the position taken by the Circuit Court of Appeals (and the Tax Court)[6] in the instanct case, which conditioned the taxpayer's right to an allowance for extraordinary obsolescence upon proof of a shortened physical life.[7]

In the case at bar there is no doubt that the loss in value resulted from the abandonment of the special use; the Tax Court so found (R. 37) and the real estate expert who testified specifically stated (R. 62) that his estimated residual value was predicated on the use of the property as an ordinary commercial warehouse rather than on the basis of its being used for the "special purpose" for which built. Nor can there be any doubt that the abandonment by Western Union was an event over which taxpayer could exercise no control.

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[5] For a complete discussion of questions of depreciation and obsolescence, see: Dewing (Appendix, infra), including analogous illustration, p. 27, infra.

[6] It may well be that the Court below fell into the same error to which the Court of Appeals of the Third Circuit called attention in the case of **Hazeltine Corporation v. Commissioner, 89 F. (2d) 513**, where it was said: "We think the Board may have fallen into this error through failing to draw a distinction between obsolescence and complete obsoleteness. It is of course true that the Neutrodyne Circuit continued capable after 1930 of performing, for those who still desired to use it, the same function in radio reception which it had theretofore and it may well be that a few persons did continue to use it after that time. This is far from saying that it was not 'obsolescent'."

[7] For criticism by a prominent Tax Service of the Tax Court's decision in the case at bar, see: **Alexander Tax News Letter, March 1944.**

Upon such facts extraordinary obsolescence should have been allowed,[8] because this Court in the **Cartridge Company case**, supra, specifically held:

> "Obsolescence may arise from * * * things which, **apart from physical** deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value." (Emphasis ours.)

The above statement of this Court is in irreconcilable conflict with the holding of the Court of Appeals in this case, which required a showing of a shortening of physical life as a condition precedent to allowing extraordinary obsolescence despite the abandonment of Petitioner's building for its "special purpose" use.

It is respectfully submitted that the writ of certiorari should be issued.

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8 "Obsolescence . . . does not 'shorten' a property's useful life . . . this is because it is a question of value and not of physical wear and tear." **Saliers, Depreciation Principles and Applications (3rd Ed.).**

See also: Dewing, Appendix, infra.